



AUG31'15 PM 2:04 BOARD

August 10, 2015

Mr. Gerard Poliquin
Secretary to the NCUA Board
1775 Duke Street
Alexandria, VA 22314

Re: Comment Letter on the Proposed Amendments to NCUA's MBL Rule

Dear Mr. Poliquin:

Pen Air Federal Credit Union (PAFCU) is pleased to comment on the NCUA's Notice of Proposed Rulemaking for 12 CFR Part 723 regarding potential changes to the Member Business Loan (MBL) regulations. Being a part of the NCUA Regulatory Modernization initiative, we appreciate the Board's considering these regulations to assist Credit Unions (CUs) in better serving their business members' needs.

PAFCU has been serving our members since 1936. We began our MBL program in 2004 and have been serviced by our Credit Union Service Organization (CUSO), The Cypress Group (Cypress), which has provided our underwriting and documentation requirements since origination of our MBL program. In addition, we have also enlisted the services of Credit Union Business Group (CUBG) for external audit of our loan files, MBL loan policy requirements, adherence of NCUA regulation, operations review, procedures, and internal operations.

I am PAFCU's AVP of Business Lending and have 23 years of business banking and commercial lending experience. I believe I would be qualified to provide feedback regarding the potential changes being proposed.

I applaud the NCUA's potential shift from specific regulatory requirements to a principles-based approach. The proposed changes will benefit us greatly in obtaining our strategic goals.

My comment letter will be segmented into four sections, as follows:

- Waiver requirements no longer being required
- Specific line items of NCUA regulation 723
- Items requested to begin immediate implementation
- Final comments

Waiver Requirements No Longer Being Required

- *Aggregate construction and development (C&D) loan* – Although we have never asked for a waiver on the aggregate C&D loan requirement, I feel each CU should understand and have the expertise to manage their construction portfolio. We extensively use a third-party vendor to provide a feasibility study as well as extensive construction monitoring for the duration of the entire process. Our monitoring process provides a level of security and soundness which mitigates the risk associated with construction.
- *Minimum borrowers equity for C&D loans* – PAFCU appreciates the NCUA's further clarification of this requirement. This item becomes a subjective issue with regulators, and this clarification will further define the current requirements.



- *LTV requirements* – PAFCU appreciates this change. We have been under much duress over the past 8 years since the “Great Recession” with regard to our ability to renew current MBL loans. With commercial real estate values down, we have had to request a waiver on numerous renewals which exceeded the loan-to-value (LTV) requirements of NCUA regulation 723. This created timing issues and member dissatisfaction. We have internally managed our portfolio well during these times, and when we felt necessary, have requested additional collateral or principal reductions from our members. There are times when this is not available and has created duress.
- *Personal guarantee requirement* – PAFCU agrees with the NCUA that CUs should always obtain unlimited personal guaranties whenever possible. Eliminating guaranties may provide additional risk, but we believe this change is needed. A case in point is a loan we recently approved for a local project. The loan would have guarantees of two corporations with assets of \$500MM each and net worth in excess of \$100MM each. Each corporation also had over \$100MM in liquid assets. Both corporations had an intricate structure with 75 equal owners for each corporation. With the current 51% personal guarantee requirement, we would have had to obtain the personal guarantee of 38 owners for each corporation. The process became too complicated and, we were not able to assist our member with a loan facility. Rarely would we waive the requirement due to our conservative nature, but having the option rather than losing a strong and well-supported loan request is extremely important. There are numerous options available to strengthen the deal other than just the requirement of the personal guarantee.
- *Max unsecured MBL to one member* – Although not a strong unsecured lender, I agree with the proposed changes on unsecured MBL loans to both each member and total aggregate to each CU.
- *Maximum aggregate MBL limit to one member or group of associated members (legal lending limit)* – Exceeding the current 15% of net worth by 10%, if the higher advance is fully secured by marketable securities or cash accounts, is clear and concise and we agree with this change.

Specific Line Items of NCUA Regulation 723

- 723.1 (b) – This change in regulation would not affect PAFCU.
- 723.1 (c)(2) – Having additional avenues with which to seek out government guarantee loans would be a welcome change.
- 723.2 and 701.22 – Further defining *associated borrower* will allow us to compete with other financial institutions and service our members.
- 723.2 – Further defining an MBL and commercial loan will allow each CU to use its risk tolerance and expertise to achieve goals.
- 723.2 and 723.4 (g)(3) – PAFCU currently has in place an extensive credit-risk grading system. This system has been tested and approved by Cypress and CUBG. This change will not affect us.
- 723.2 – Excluding junior liens from LTV ratio calculations will reflect other financial institution requirements.
- 723.2 and 723.4 (c) – Further defining readily marketable collateral to allow for a member to exceed current legal lending limits will allow greater member service to larger MBL members.
- 723.3 – The changes to this section will not affect PAFCU as our Board of Directors (BOD) and management team have had extensive training and/or experience regarding more complicated lending. Our (BOD) and management team also approve and manage all changes to the MBL Policy. Our BOD also reviews the PAFCU MBL Policy annually. A principles based approach should be reflective of experience. We have always been under the opinion that two years of experience is a minimal experience level for smaller MBL loans. This change requiring experience commensurate with specific lending skills will be welcome. I do have concerns that regulators will apply this concept unequally and should be careful in their interpretation. Because a lender has never underwritten a “mini-warehouse” loan does not mean a lender would not understand the concept of how to underwrite this type of loan. Understanding the basic



concepts of lending is clearly more critical than just having experience in a particular sector of commercial/business lending. We agree with the NCUA regarding current and proposed oversight requirements.

- 723.4 – I have already commented above on limits to individual members or group of members. In policy, PAFCU has already established lending limits, specific underwriting guidelines, and risk management processes. This change should not affect PAFCU.
- 723.5 (a) – The need for a new LTV limit requirement will apply mostly during renewal of current loans. We do not stray from the current LTV requirements and mostly stay on the conservative side when looking at loan requirements. This is evident in vacant commercial land requirements. Since there truly is no LTV limit on vacant land specified in regulation 723, we usually adhere to a 50%-65% LTV limit due to their inherent risk and their being the cause of many losses of financial institutions in the "Great Recession." Most CUs understand this risk and abide by their CU's risk tolerance and current markets.
- 723.5 (b) – I have already discussed the very important need for this requirement above.
- 723.6 – Although we have not exceeded this arbitrary limit, we have come close based on our growth area in the Southeast. We manage our risk on our construction lending and mostly use professional third-party vendors with extensive construction monitoring experience. It is also important that a C&D loan is more thoroughly defined and we applaud the NCUA for further clarification.
- 723.8 (a) – This change will not affect us. We are currently using the lesser of 1.75X our equity or 12.25% of assets. We have, since my arrival 8 years ago, always used the latter as our target in our MBL program cap. We have in the past come very close to this target and created a situation where we could not help some members due to our restriction of the MBL cap. With the understanding that the regulation will change to 1.75X of the 7% capital of the assets of a CU, this will minimally allow us to increase our cap. A preferred recommendation would be to change the verbiage of the current regulation from the lesser to the greater. Because PAFCU is a very well capitalized CU at nearly 12%, taking the greater of the two will increase our allowance of the cap. Case in point, as of the end of July 2015, with the difference of the two calculations above, our increase in allowed MBL cap will be over \$107MM. This alone will ensure our ability to assist our business membership. It is almost unfair to extremely well-capitalized CUs to limit our ability to increase our MBL program. We welcome the change but would prefer the greater of designation.
- 723.8 (b) – Without the above change, this change will be key to our future growth as well as to the growth of other CUs. Participations, when handled properly, will allow PAFCU to diversify our portfolio in several ways. One is the geographic location concentration. Being in Florida, we saw a greater decline in real estate values than other areas in the nation did. If our portfolio could have been more diversified we would have had much less risk than we did by having commercial real estate loans in the state of Florida. We understand that we lend in our market and serve our members, but with a geographically-diversified portfolio coupled with raising the cap limits (as described above), we reduce the risk. Participations will also allow us to diversify our portfolio in other areas of lending. PAFCU is in Northwest Florida, and our economy is made up of three major areas: healthcare (due to being a retirement town), tourism, and churches (being in the Bible Belt). These three areas make up a great portion of our portfolio. Being able to work with other CUs, as well as being a part of the CUBG network, we will be able to diversify our portfolio to lessen concentration risk in certain business sectors. We believe each CU will need to clarify its risk tolerance with participation purchases and will need to limit the amount of participations purchased to a percentage of their total MBL portfolio or the net worth of the CU. If there are unlimited participation dollars allowed, a CU could purchase participations and solely allow the originating CU the responsibility of monitoring. We see this as a risk and that it should be further explained and clarified and should be based on the experience of the staff and management of each CU. A seasoned MBL program will allow the ability to ascertain the risks associated with each participation purchased. This change will



be the only item which will allow each CU to increase the business lending cap with the designation of a commercial loan instead of an MBL.

- 723.8 (d) – With our experienced staff, The Cypress Group, and CUBG, this change would allow us to further our MBL lending without the need to demonstrate our qualifications in business lending.
- 723.9 – 723.20 – Removing waiver requests, allowing each CU to use its expertise in MBL lending, will allow us to serve our MBL members in a timely fashion. This is more critical in the renewal process, but it is very important when our CU has the ability, experience, and expertise to determine a strong loan and to understand the risk associated with each loan.

Items Requested to Begin Immediate Implementation

The proposed regulation states that there will be an 18-month implementation timeline. We understand the need to understand and implement the changes; however, we believe that this timeline should be removed from items which could be implemented immediately. The changes being requested below will have an immediate positive affect on each CU. CUs with the experience to handle the immediate changes will benefit greatly from the immediate changes.

Personal Guarantee – CUs with extensive internal experience and those which utilize the services of a CUSO have the ability to understand the need for a personal guarantee. There are cases in which a personal guarantee cannot be obtained, as explained above, and we will forfeit opportunities for strong loans to our competitors. This could easily be changed with slight modifications to policies and procedures.

C&D Loans – CUs are already processing C&D loans. With the further clarification from NCUA on what constitutes a C&D loan, equity requirements of our members, and arbitrary LTV limits on C&D loans, each CU will be allowed to move forward with minimal modifications to policy. With a strong construction monitoring system, this requirement can be implemented immediately.

LTV Limits – CUs with seasoned MBL portfolios realize the need to remove this requirement immediately. If the change is not deemed removable immediately, we recommend that LTV limits on renewed loans currently with the CU not require the LTV waiver; this change would make it possible to avoid delays to our members. Not only does the current requirement delay the process, it creates a barrier of mistrust between the CU and the member. I did lose a loan in 2014 due to this process. When I explained how the process works, our member stated that there was a possibility that the loan would not be approved. Without speaking for our examiner, I had to tell our member that was indeed a possibility. Our appraisal came back extremely low, and we knew the appraiser had taken a VERY conservative approach to the value. Our member then went to a bank and had another appraisal completed; LTV on the appraisal by the bank was within 80% LTV, and our member moved his relationship to the bank. It hurts when we lose the faith and trust of our membership due to timing delays and uncertainties. I also would state that this member had his loan with PAFCU for 5 years, made all payments on time, recommended his business colleagues to us due to our excellent member service, is a businessperson well thought of in the local community, etc. This was a great loss to our CU and an extreme risk to our reputation in our community.

MBL Cap – Changing immediately the verbiage of “the lesser of” 1.75X equity or 12.25% of assets to “the greater of” would be beneficial to well-capitalized CUs. As stated above, we are a very well-capitalized CU, working with 11.73% capital as of the end of July 2015. This change would increase the lending of many CUs with no risk involved.



Participations – As stated above, this is the only item which would allow CUs to grow their portfolio over the current MBL cap. A seasoned MBL program will be able to understand the risk involved with a loan being purchased. Minimal changes to policy would be required.

The remainder of the items could follow the NCUA guidance of having the changes implemented over the next 18 months. Most of the remainder of the items would need time to allow for implementation and training.

Final Comments

We again applaud the NCUA on the changes being proposed. We understand and agree with moving from a strict regulatory approach to a principal-based approach. However, we have concern that the changes will allow regulators to have a larger opinion on how to interpret the changes which may differ for each CU. Another area of concern is that the new approach will create a large amount of judgment by examiners. Although experience is increasing and MBL examiners from other regulatory sources are being hired, we see the need for continued training and understanding of the requirements of the NCUA as presented. We agree with the training budget being proposed by the NCUA but would prefer this to be a part of the annual budget and not a separate line item. We would also ask to be a part of any regulatory guidance to ensure that the intentions behind the changes being proposed are being passed down from the NCUA to the regulatory body and to the CU.

We appreciate the opportunity to provide input regarding the NCUA's proposed changes to the MBL regulations. Please feel free to contact me for clarification or further discussion on any of these items.

Sincerely,

A handwritten signature in black ink, appearing to read 'Tom Furr', with a long, sweeping horizontal line extending to the right.

Samuel "Tom" Furr
AVP/Business Lending Manager